# INDONESIA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

## Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

| | 1996 | 1997 | 1998 | |
|---|---|---|---|---|
| *Income, Production and Employment:* | | | | |
| Nominal GDP | 221 | 211 | 43 | 1/ |
| Real GDP Growth (pct) | 8.1 | 7.6 | -13.2 | 1/ |
| GDP by Sector: 1/ | | | | |
| Agriculture | 33.5 | 34.5 | 8.6 | |
| Manufacturing | 50.0 | 54.9 | 10.6 | |
| Services | 71.0 | 67.5 | 13.5 | |
| Government | 10.4 | 11.5 | 1.6 | |
| Per Capita GDP (US$) | 1,014 | 1,116 | 500 | 2/ |
| Labor Force (millions) | 85.7 | 87.0 | 92.6 | |
| Unemployment Rate (pct) | 4.4 | 4.6 | 10 | |
| *Money and Prices (annual percentage growth):* | | | | |
| Money Supply (M2) | 28 | 31 | 52 | 3/ |
| Consumer Price Inflation (pct) 4/ | 9.0 | 8.0 | 75.0 | 4/ |
| Exchange Rate (Rupiah/US$ annual average) | 2,335 | 2,909 | 10,422 | 5/ |
| *Balance of Payments and Trade:* 6/ | | | | |
| Total Exports FOB | 48.2 | 54.8 | 29.0 | |
| Exports to U.S. | 8.2 | 9.2 | 5.2 | |
| Total Imports CIF | 43.3 | 50.4 | 19.5 | |
| Imports from U.S. | 4.0 | 4.5 | 1.3 | |
| Trade Balance | 4.9 | 4.4 | 9.5 | |
| Balance with U.S. | 4.2 | 4.7 | 3.9 | |
| External Public Debt | 59.0 | 56.4 | 65.6 | 7/ |
| Debt Service Payments/GDP (pct) | 5.1 | 3.8 | 1.5 | 7/ |
| Current Account Deficit/GDP(pct) | 3.6 | 2.3 | N/A | |
| Fiscal Deficit/GDP (pct) | -1.0 | 0.1 | 8.5 | |
| Gold and Foreign Exchange Reserves (end of period) | 19.1 | 19.9 | 21.8 | 8/ |
| Aid from U.S. (millions of US$) | 96 | 71 | 250 | |

| | | | |
|---|---|---|---|
| Aid from All Other Sources | 5.3 | 5.2 | N/A |

1/ 1998 estimates are for January-June. (Average Rp/US$ exchange rates were 9,433 for January-March and 10,461 for April-June.)
2/ 1998 per capita GDP figure is rough estimate; actual figure depends on Rp/US$ exchange rate, which was volatile throughout 1998.
3/ 1998 figure is for January-August.
4/ 1998 figure is for January-October.
5/ 1998 figure is average of Bank Indonesia monthly exchange rates for January-October.
6/ 1998 figures are January-July.
7/ 1998 figure is as of March 31.
8/ 1998 figure is Gross Foreign Assets as of November 6, 1998.

Sources: Government of Indonesia, US Department of Commerce (for trade with U.S.), and IMF (exchange rates).

*1. General Policy Framework*

Indonesia was widely hailed as a leading economic success story as recently as mid-1997. Real GDP growth averaged over 7 percent per year for the decade since 1987. GDP per capita surpassed $1,000 by 1996, compared with $70 in 1965. The rupiah was stable, annual inflation was reported in the single digits, and foreign capital was pouring in.

The economic crisis that began in July 1997 changed all that. Indonesia experienced severe drought, low world petroleum prices, regional financial instability, domestic social unrest, and, ultimately, a change of government. By mid-1998, the government estimated that real GDP would contract 13 percent during 1998; private analysts projected a decline of at least 15 percent. GDP per capita had declined to $450. The exchange rate plummeted from 2,450/US$ in June 1997 to 15,000/US$ a year later; as of December 1998, it stood at approximately 7,500/US$. Exchange rate volatility made business planning all but impossible. Annual inflation was running at an estimated 80 percent. Foreign capital had fled, closing off access to new foreign lending, while the business sector struggled to service existing foreign debts at the weaker exchange rate. Most observers agreed that the economy had not yet bottomed out as of late 1998, making it difficult to chart a path toward recovery.

The shock waves from this sudden reversal of fortune reverberated among a generation familiar only with economic growth. The reversal cast into stark relief weaknesses that were downplayed during the preceding high growth period, including presidential succession uncertainty, corruption, collusion, nepotism, a weak banking sector, and the large but then-unknown amount of foreign commercial debt. As employment dropped and prices rose, the loss of purchasing power, particularly among lower income groups, raised concerns about the ability of the population to feed itself and about the potential for social unrest. In May 1998, after fuel prices were increased and demonstrating students were shot, riots and looting swept Jakarta and other cities, leading to the May 21 resignation of President Soeharto, who was replaced by his Vice President, B.J. Habibie. President Habibie announced that legislative elections would be held in May 1999. The government and the IMF reached agreement on a stabilization program that amended the program inaugurated in November 1997. The exchange rate had strengthened from its mid-year low and the rate of inflation exhibited signs of decelerating. The November 1998 special session of the People's Consultative Assembly which, inter alia, agreed to parliamentary elections the following spring, was marred by violence.

The deep financial, economic, and political crisis that developed during 1997-98 obscured underlying strengths of the Indonesian economy. With a population of 201 million, the world's fourth largest country was the anchor of Southeast Asia and a sizable market with an emerging middle class. Its strategic location, large labor force earning relatively low wages, abundant natural resources, financial and trade sector deregulation efforts, and stable political climate had unleashed a domestic and foreign investment boom and fueled the development of a robust manufacturing economy concentrated on the main island of Java. Once dependent on petroleum, natural gas, and commodities including coffee, tea, spices, timber, and shrimp, Indonesia by 1997 exported $45 billion in non-petroleum, labor-intensive products such as garments, footwear, plywood, and basic machinery, on top of its $12 billion in oil and gas exports. It had also become a significant market and imported $5 billion in goods from the United States in 1997.

The Indonesian Government has historically maintained a "balanced" budget: expenditures were covered by the sum of domestic revenues and foreign borrowing, without resort to domestic borrowing. Often the government ended the year with a slight surplus. This fiscal year (April 1998-March 1999), the gap between domestic revenues (shrinking because business was moribund, and because oil prices were low) and expenditures (skyrocketing, because of subsidies for basic goods and IMF-encouraged spending on the social safety net) will be large, perhaps 8.5 percent of GDP or over $8 billion. The challenge for the government was to balance the need for continued subsidies on essential goods against the need for fiscal prudence. Foreign financing was considered key to maintaining that balance. In July 1998, international financial institutions and bilateral donors pledged an extraordinary increase in financial support to Indonesia for social safety net outlays.

In parallel with its fiscal policy, the Indonesian Government earned a reputation for prudent monetary policy in recent years that helped keep consumer price inflation in the single digits. However, the massive depreciation of the rupiah that began in mid-1997 (after the government decided to let the rupiah float freely rather than deplete its reserves in an effort to defend the rate) and huge liquidity injections into the banking system contributed to significant inflation. Indonesian monetary authorities attempted to dampen inflationary pressure and reduce pressure on the exchange rate by controlling the growth of the money supply .

The government has made steady progress in trade and investment deregulation, usually by periodically implementing "deregulation packages" of liberalization measures. Through these packages, the government has lowered investment barriers and instituted a program of comprehensive tariff reduction by staged cuts. Its goal is to reduce all tariffs in the 1-20 percent range to 5 percent or less by 2000, and to reduce all tariffs in the 20 percent and higher range to 10 percent or less by 2003. Although the deregulation packages made comparatively less progress in reducing non-tariff barriers, the government's collaboration with the International Monetary Fund (IMF) since November 1997 prompted much bolder measures, ending most import monopolies and gradually opening Indonesia's closed distribution system.

## 2. *Exchange Rate Policies*

In August 1997, the government eliminated the rupiah intervention band in favor of a float.

## *3. Structural Policies*

In October 1997, declining conditions led Indonesia to request support from the International Monetary Fund (IMF). The government signed its first Letter of Intent with the IMF on October 31. The letter called for a three-year economic recovery program, supported by loans from the IMF ($10 billion), the World Bank, the Asian Development Bank, and bilateral donors. Apart from financial support, the international community also offered detailed technical assistance to the government. Foreign governments and private organizations also contributed food and other humanitarian assistance.

Indonesia's agreement with the IMF has been revised repeatedly in response to deteriorating macroeconomic conditions. The result is a complex, multi-faceted program to address macroeconomic imbalances, financial weaknesses, real sector inefficiencies, and the loss of private sector confidence. The latest versions of the program expand the focus of the earlier programs to cover the entire spectrum of economic challenges facing Indonesia, including: fiscal and monetary policy; structural reform and deregulation; corporate debt and bankruptcy; banking sector reform and restructuring; trade financing; food security; and social safety net policies.

*4. Debt Management Policies*

Indonesia's foreign debt totaled about $138 billion as of September 1998, with about $65 billion owed by the public sector and $73 billion by the private sector. In 1998, Indonesia signed a Memorandum of Understanding with its official creditors to reschedule public sector debts contracted before July 1, 1997.

In late 1998, the government was discussing establishment of a monitoring system to collect information on all foreign exchange transactions, including foreign borrowing. Borrowing in connection with state-owned enterprises has been regulated since 1991. The government continued to assert that it would not impose capital controls.

*5. Significant Barriers to U.S. Exports*

Indonesia had previously maintained a complex and non-transparent import licensing system which was a significant impediment to trade. Since the advent of the economic crisis in 1997, the government has removed numerous licensing requirements and committed in its IMF agreement to phase out all quantitative import restrictions (other than those justified for health, safety, and environmental reasons) and other nontariff barriers that protect domestic production.

Services Barriers: Despite some loosening of restrictions, services trade entry barriers remain in many sectors. Commercial presence is required to offer insurance in Indonesia and foreign firms must form joint ventures with local companies. As of July 1998, foreign participation in telecommunications services is no longer limited. PT Telkom is the state-owned monopoly provider of fixed line services. Telkom has exclusive rights to provide nationwide fixed line telecommunications until 2011 and to provide domestic long distance services until 2006. The government has allowed five foreign telecommunications companies to partner with local firms and operate joint ventures to build, maintain, and operate local fixed-line networks.

Foreign accounting firms must operate through technical assistance arrangements with local firms, but Indonesian citizenship is no longer a requirement for licensing as an accountant. Foreign agents and auditors may act only as consultants and may not sign audit reports. Foreign law firms are not allowed to establish practices in Indonesia. Attorneys are admitted to the bar only if they have graduated from an Indonesian legal faculty or an institution recognized as the equivalent. Foreign companies incorporated in Indonesia may issue stocks and bonds through the capital market.

Investment Barriers: The government is committed to reducing burdensome bureaucratic procedures and substantive requirements for foreign investors. In 1994, the government dropped initial foreign equity requirements and sharply reduced divestiture requirements. Indonesian law provides for both 100 percent direct foreign investment projects and joint ventures with a minimum Indonesian equity of 5 percent. In mid-1998, the government opened several previously restricted sectors to foreign investment, reducing the number of sectors restricted for foreign direct investment to 25, 16 of which are completely closed to investment while the remaining 9 allow minority foreign equity participation. The restricted sectors include taxi and bus transportation, local shipping, cinema operation, private broadcasting and newspapers, medical services, and some trade services. The government also removed foreign ownership limitations on banks and on firms publicly traded on Indonesian stock markets.

Most foreign investment proposals must be approved by the Capital Investment Coordinating Board (BKPM). Investments in the oil and gas, mining, forestry, and financial services are covered by specific laws and regulations and handled by the relevant technical ministries.

Government Procurement Practices: In 1994, the government enacted a Procurement Law to regulate government procurement practices and strengthen the procurement oversight process. Most large government contracts are financed by bilateral or multilateral donors who specify procurement procedures. For large projects funded by the government, international competitive bidding practices are to be followed. The government seeks concessional financing which includes a 3.5-percent interest rate and a 25-year repayment period, with a 7 year grace period as well. Some projects do proceed on less concessional terms. Foreign firms bidding on certain government-sponsored construction or procurement projects may be asked to purchase and export the equivalent in selected Indonesia products. Government departments and institutes and state and regional government corporations are expected to utilize domestic goods and services to the maximum extent feasible, but this is not mandatory for foreign aid-financed goods and services procurement. State-owned enterprises which have offered shares to the public through the stock exchange are exempted from government procurement regulations.

*6. Export Subsidies Policies*

Indonesia joined the GATT Subsidies Code and eliminated export loan-interest subsidies as of April 1, 1990. As part of its drive to increase non-oil and gas exports, the government permits restitution of VAT paid by a producing exporter on purchases of materials for use in manufacturing export products. Exemption from or drawbacks of import duties are available for goods incorporated into exports. Free trade zones and industrial estates are combined in several bonded areas. In the past two years, the government has gradually increased the share of production that firms located in bonded zones are able to sell domestically up to 100 percent in 1998.

*7. Protection of U.S. Intellectual Property*

Indonesia is a member of the World Intellectual Property Organization (WIPO) and in 1997 became full party to the Paris Convention for the Protection of Intellectual Property, the Berne Convention for the Protection of Literary and Artistic Works, the Patent Cooperation Treaty, and the Trademark Law Treaty. Indonesia was the first country in the world to ratify the WIPO Copyright Treaty, but has not ratified the companion WIPO Performances and Phonograms Treaty. In April 1998, the U.S. Trade Representative placed Indonesia on the Special 301 Priority Watch List, where it has been since 1996.

Indonesia has serious and continuing deficiencies in its intellectual property regime: rampant piracy (software, books, video), trademark piracy, an inconsistent enforcement and ineffective legal system, and laws that are inconsistent with the WTO's Trade Related Aspects of Intellectual Property (TRIPs).

Indonesia is taking steps towards improving intellectual property protection, but still has far to go. New patent, trademark, and copyright laws were enacted in May 1997 in order to bring Indonesia's laws into compliance with the TRIPs Agreement. The laws addressed many of the remaining inadequate penalties, but lax enforcement and a judicial system unfamiliar with intellectual property law still pose daunting problems for U.S. companies. The government often responds to U.S. companies which put forward specific complaints about pirated goods and trademark abuse, but the court system can be capricious, and punishment of pirates of intellectual property has been rare.

Indonesia's 1997 Patent Law addressed several areas of concern to U.S. companies, including compulsory licensing provisions, a relatively short term of protection, and a provision which allowed importation of 50 pharmaceutical products by non-patent holders.

Biotechnology and integrated circuits are not protected under Indonesia intellectual property laws. The government is in the process of preparing laws on trade secrets, industrial design, and integrated circuits.

*8. Worker Rights*

*a. The Right of Association:* Private sector workers, including those in export processing zones, are by law free to form worker organizations without prior authorization. In May 1998, the government issued a new regulation on registration of workers' organizations. The new regulation eliminates numerical and other requirements which were previously a barrier to union registration, but prohibits unions based on political orientation, religion, gender, or ethnic groups. The government also ratified International Labor Organization (ILO) Convention 87 on Freedom of Association in June 1998. Since the regulation went into effect, at least 10 new or previously unrecognized unions have begun organizing themselves to register. The government may dissolve a union if it believes the union is acting against the national ideology, Pancasila, although it has never actually done so, and there are no laws or regulations specifying procedures for union dissolution.

The government is considering other legislative and regulatory changes in regard to trade unions, industrial dispute resolution, and labor affairs generally. To allow time for new laws and regulations, the parliament amended a 1997 Basic Law on Manpower Affairs by postponing its implementation until the year 2000.

Civil servants must belong to KORPRI, a nonunion association whose central development council is chaired by the Minister of Home Affairs. State enterprise employees, defined to include those working in enterprises in which the state has a 5-percent holding or greater, usually are required to join KORPRI, but a small number of state enterprises have FSPSI units. Teachers must belong to the teachers' association (PGRI). All organized workers except civil servants have the legal right to strike. While state enterprise employees and teachers rarely exercise this right, private sector strikes are frequent.

*b. The Right to Organize and Bargain Collectively:* Registered unions can legally engage in collective bargaining and can collect dues from members through a checkoff system. In companies without unions, the government discourages workers from utilizing outside assistance, preferring that workers seek its assistance. By regulation, negotiations must be concluded within 30 days or be submitted to the Department of Manpower for mediation and conciliation or arbitration. Agreements are for two years and can be extended for one year. According to NGOs involved in labor issues, the provisions of these agreements rarely go beyond the legal minimum standards established by the government, and the agreements are often merely presented to worker representatives for signing rather than being negotiated.

Although government regulations prohibit employers from discriminating or harassing employees because of union membership, there are credible reports from union officials of employer retribution against union organizers, including firing, which is not effectively prevented or remedied in practice. Charges of antiunion discrimination are adjudicated by administrative tribunals. However, because many union members believe the tribunals generally side with employers, many workers reject or avoid the procedure and present their grievances directly to the national human rights commission, parliament and other agencies. Administrative decisions in favor of dismissed workers tend to be monetary awards; workers are rarely reinstated. The provisions of the law make it difficult to fire workers, but the law is often ignored in practice.

The armed forces, which include the police, continue to involve themselves in labor issues, despite the Minister of Manpower's revocation in 1994 of a 1986 regulation allowing the military to intervene in strikes and other labor actions. A 1990 decree gives the Agency for Coordination of National Stability (BAKORSTANAS) authority to intervene in strikes in the interest of political and social stability remains in effect.

*c. Prohibition of Forced or Compulsory Labor:* The law forbids forced labor, and the government generally enforces it. However, according to credible sources, there are several thousand children working on fishing platforms off the East Coast of North Sumatra in conditions of bonded labor. Most are recruited from farming communities, and once they arrive at the work site, are not permitted to leave for at least three months and until a replacement worker can be found. Children receive average monthly wages that are well below the minimum wage. They live in isolation on the sea, working 12 to 20 hours per day in often dangerous conditions, sleeping in the workspace with no access to sanitary facilities. There are reports of physical, verbal and sexual abuse of the children.

*d. Minimum Age for Employment of Children:* Child labor exists in both industrial and rural areas, and in both the formal and informal sectors. According to a 1995 report of the Indonesian Central Bureau of Statistics, four percent of Indonesian children between the ages of 10 and 14 work full-time, and another four percent work in addition to going to school. Many observers believe that number to be significantly understated, because documents verifying age are easily falsified, and because children under 10 were not included. Indonesia was one of the first countries to be selected for participation in the ILO's International Program on the Elimination of Child Labor (IPEC). Although the ILO has sponsored training of labor inspectors on child labor matters under the IPEC program, enforcement remains lax.

*e. Acceptable Conditions of Work:* Indonesia does not have a national minimum wage. Rather, area wage councils working under the supervision of the national wage council establish minimum wages for regions and basic needs figures for each province -- a monetary amount considered sufficient to enable a single worker to meet the basic needs of nutrition, clothing, and shelter. In Jakarta, the minimum wage is about $25 (rp 198,500) per month (at an exchange rate of rp 8000 to the dollar). That is 76 percent of the government-determined basic needs figure. There are no reliable statistics on the number of employers paying at least the minimum wage. Independent observers' estimates range between 30 and 60 percent.

Labor law and ministerial regulations provide workers with a variety of other benefits, such as social security, and workers in more modern facilities often receive health benefits, free meals, and transportation. The law establishes 7-hour workdays and 40-hour workweeks, with one 30-minute rest period for each 4 hours of work. The law also requires one day of rest weekly. The daily overtime rate is 1-1/2 times the normal hourly rate for the first hour, and twice the hourly rate for additional overtime. Observance of laws regulating benefits and labor standards varies from sector to sector and by region. Employer violations of legal requirements are fairly common and often result in strikes and employee protests. The Ministry of Manpower continues publicly to urge employers to comply with the law. However, in general, government enforcement and supervision of labor standards is weak.

Both law and regulations provide for minimum standards of industrial health and safety. In the largely western-operated oil sector, safety and health programs function reasonably well. However, in the country's 100,000 larger registered companies in the non-oil sector, the quality of occupational health and safety programs varies greatly. The enforcement of health and safety standards is severely hampered by the limited number of qualified Department of Manpower inspectors as well as by the low level of employee appreciation for sound health and safety practices. Allegations of corruption on the part of inspectors are common. Workers are obligated to report hazardous working conditions. Employers are forbidden by law from retaliating against those who do, but the law is not effectively enforced.

*f. Rights in Sectors with U.S. Investment:* Working conditions in firms with U.S. ownership are widely recognized as better than the norm for Indonesia. Application of legislation and practice governing worker rights is largely dependent upon whether a particular business or investment is characterized as private or public. U.S. investment in Indonesia is concentrated in the petroleum and related industries, primary and fabricated metals (mining), and pharmaceutical sectors.

Foreign participation in the petroleum sector is largely in the form of production sharing contracts between the foreign companies and the state oil and gas company, Pertamina, which retains controls over all activity. All employees of foreign companies under this arrangement are considered state employees and thus all legislation and practice regarding state employees generally applies to them. Employees of foreign companies operating in the petroleum sector are organized in KORPRI. Employees of these state enterprises enjoy most of the protection of Indonesia labor laws but, with some exceptions, they do not have the right to strike, join labor organizations, or negotiate collective agreements. Some companies operating under other contractual arrangements, such as contract of work and, in the case of the mining sector, cooperative coal contracts, do have unions and collective bargaining agreements.

Regulations pertaining to child labor and child welfare are applicable to employers in all sectors. Employment of children and concerns regarding child welfare are not considered major problem areas in the petroleum and fabricated metals sectors. Legislation regarding minimum wages, hours of work, overtime, fringe benefits, health and safety applies to all sectors. The best industrial and safety record in Indonesia is found in the oil and gas sector.

**Extent of U.S. Investment in Selected Industries** -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

| Category | | Amount |
|---|---|---|
| Petroleum | | 4,768 |
| Total Manufacturing | | 358 |
| Food & Kindred Products | 18 | |
| Chemicals & Allied Products | 189 | |
| Primary & Fabricated Metals | 13 | |
| Industrial Machinery and Equipment | -9 | |
| Electric & Electronic Equipment | 62 | |
| Transportation Equipment | (1) | |
| Other Manufacturing | (1) | |
| Wholesale Trade | | 39 |
| Banking | | (1) |
| Finance/Insurance/Real Estate | | 42 |
| Services | | 31 |
| Other Industries | | (1) |
| TOTAL ALL INDUSTRIES | | 7,395 |

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.